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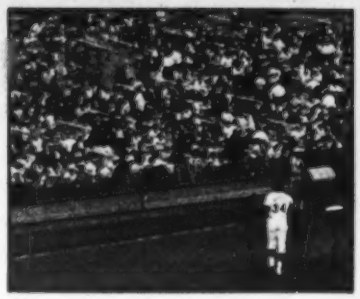
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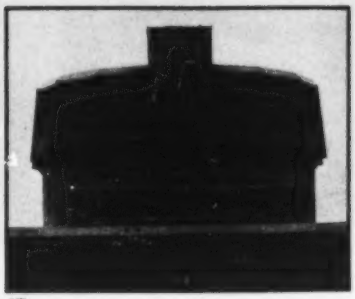
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Why do they go after the oil industry? Because that's where the money is. The pols are swarming around it like flies to spilled honey.

The honey pot

By William Baldwin

THE STATE OF CONNECTICUT thought it found a dandy way of coming up with $60 million of new tax revenues annually: Slap a "gross-receipts" tax on oil companies doing business in the state *and* prohibit them from passing it along to Connecticut customers. Cash for the spenders in the state capital; no pain for the taxpayers. The law was in effect for less than two weeks when a federal judge on July 9 declared the no-pass-through feature unconstitutional. But the game isn't over yet. Tax collectors from Philadelphia to Juneau are busy raiding the oil industry larder, and they see this as only a temporary setback.

Despite the Connecticut decision, New York State is forging ahead with a similar 2% gross-receipts tax. Gasoline taxes are jumping by up to 4 cents a gallon this year in ten states: Alabama, Indiana, Kentucky, Minnesota, Nebraska, New Mexico, South Carolina, South Dakota, Virginia and Wisconsin (*see chart*). The District of Columbia, which already has a 10-cents-a-gallon rate, will subject gas to its 6% sales tax. Oil severance taxes, levied at the wellhead, are going up in Kentucky and New Mexico, and a petition drive is under way to double them in North Dakota. A Maryland legislative committee is trying to figure out how to piggyback on the federal windfall-profits tax.

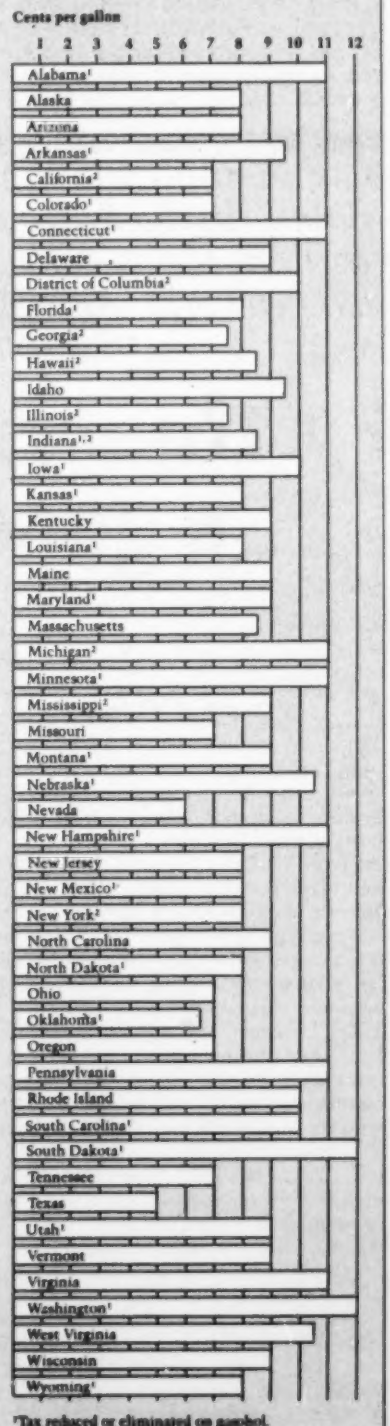
With decontrol of domestic oil under way, first-quarter profits for 25 U.S. oil companies this year totaled $9.6 billion, up 110% from a year earlier. Clearly, as Willie Sutton used to say, that's where the money is. Taxing oil companies could even be considered patriotic: If taxes go up and prices go up, people would use less, cutting down on foreign oil. But the pols in states like Connecticut wouldn't let it work that way: By forbidding the oil companies to pass on the tax, they hoped to slip their hands into the till without the motorist even noticing. Happily, the courts are likely to stop that cute little game.

Meanwhile, jumping on the tax bandwagon, self-appointed consumerists are arguing that since states like Alaska, Texas and Louisiana derive big taxes from revenues from oil, so should other states. "The consuming states are just trying to catch up," Robert M. Brandon of the Washington, D.C.-based Citizen Labor Energy Coalition (CLEC) says glibly. His labor-liberal group plans to promote Connecticut-style taxes in a dozen states next year.

The consumerists look longingly at states like Alaska, whose 1% oil severance tax at the time of the Prudhoe Bay discovery has grown to 12¼%—on top of a 12½% royalty on state leases. Altogether, the oil industry will pour $3.3 billion into the Alaska treasury this year, or $8,000 for every one of the state's 412,000 citizens. There's a big difference, of course. The oil-producing states are taxing their own oil; Connecticut and the other states are trying to tax somebody else's.

Fill 'em up

State governments raised $9.8 billion in motor fuel excises last year, mostly through gasoline taxes. The present bite, state by state:



[1]Tax reduced or eliminated on gasohol.
[2]State also levies a sales tax on gasoline.
Sources: National Conference of State Legislatures, Federation of Tax Administrators.

One possible approach to the oil industry honey pot is through imposing the state corporate income tax under the unitary method—figured on a company's worldwide profits. This neatly avoids "accounting manipulations," says Jonathan Rowe, a tax lawyer who pushes the unitarian philosophy from a Washington, D.C. organization called Citizens for Tax Justice. And while the gross-receipts tax may have problems in the courts, the unitary tax was given a boost in two U.S. Supreme Court decisions this year. Under them, Vermont and Wisconsin got the right to tax Mobil and Exxon, respectively, on such things as dividends from foreign subsidiaries. Crows Rowe: "The states are just waking up to what's going on in this field." CLEC's Brandon sees unitary taxes as a billion-dollar windfall for states that haven't tried it.

The oilmen are running scared. They spent more than $5 million in California this spring to defeat Proposition 11, which would have put a surcharge of 10% on their income taxes. In Philadelphia, Gulf and ARCO are making "donations" to the city treasury of $2.6 million each. It was either that or pay a 10-cents-a-barrel refining tax on nearly 350,000 barrels a day of production.

"The Barbary pirates at work," sighs William Mahoney, an official of the American Petroleum Institute. It wouldn't be so bad if people had faith in the politicians' ability to spend the money wisely—to reduce our dependence on foreign oil, for example. But who believes in that? ■

Washington complains about the lack of regulation in the Euromarkets. That very lack of regulation has helped the world get through two petrodollar recycling crises.

Tinkering with a good thing

By Thomas C. O'Donnell

ANY CURRENCY DEPOSITED outside its country of origin becomes Eurocurrency. If the currency happens to be dollars, then they are called Eurodollars. One big reason there are so many Eurodollars around is that the U.S. has been running giant deficits in its balance of payments for many years, and when dollars flow out of the country and don't come back they change from dollars with a small "d" to Eurodollars. It's as simple as that.

The bureaucrats are dying to get their hands on this vast pool of money. For years the Federal Reserve has tried to convince foreign central banks to impose reserve requirements on the Eurocurrency deposits of banks under their control. And in 1979 Rep. Jim Leach (R–Iowa) introduced a bill that would have done just that, on the offshore deposits of U.S. banks. Fortunately both proposals have come to naught, and are in fact a terrible idea.

The glut of Eurodollars is one of those situations everybody likes to talk about but few people understand. Dennis Weatherstone, third in command at Morgan Guaranty Trust Co., spends much of his time trying to explain Euromarkets to the people who matter. It's not an easy task. What people don't properly understand they tend to fear.

But what about the danger that the Arabs might try to punish the West by pulling their Eurocurrency deposits out of the banks? What about the machinations of multinational companies, quietly shifting their funds from currency to currency? Without the wise guidance of their governments, haven't the banks put themselves and their nations excessively at risk? Weatherstone, an Englishman who won his spurs in Morgan's London office, shakes his head in disbelief at these old wives' tales. Where would the Arab money go? If it comes out of one bank, it must go into another.

"Anyone who thinks the Arabs would bury billions under the desert or under their mattresses doesn't understand how the international financial system works," snorts one New York banker. "A bank that suddenly loses deposits could simply buy them back in the Euromarket, something that would raise its cost of funds but not threaten its viability."

Suppose the Arabs put large sums into real estate or gold. The money would eventually flow back into the banking system. Even as a weapon, Eurodollars are double-edged.

Last November the Carter Administration imposed its freeze on Iranian assets because Iran had threatened to pull money out of U.S. banks. It was a clear signal to hostile nations and potentially hostile ones that the U.S. would not sit still and allow anyone to use Eurocurrencies as a political weapon.

So, far from being an uncontrollable monster, the Euromarket is simply the world's largest "free" market, the virtues of which—simplicity, speed and efficiency—bankers never tire of praising. It has worked remarkably well since it sprang up in London in 1957. Money is deposited and lent with little bureaucratic interference, no reserve requirements and no insurance. Thus, loans can be made at rates far below those prevailing in the U.S., the factor accounting for the market's astonishing growth.

Although that growth has topped 25% in recent years, the market is far smaller than is generally estimated. Indeed, if interbank transactions are discounted—as they should be since they are not money—the market totals around $600 billion. But even that figure may be too high. According to the most reliable study to date, completed last year by the Bank for International Settlements, the true size of the market is between $100 billion and $150 billion. Explains Lawrence Kudlow, an economist with Bear, Stearns: "When you create this image of an uncontrollable monster, you create the mechanism by which central banks can get their claws into it."

Originally, dollars were the sole currency in the Euromarket, so the term Eurodollar came into vogue. The dollar still accounts for 80% of the market, with Eurofrancs, sterling, Euroyen and other denominations making up the rest. The various currencies are referred to collectively as Eurocurrency.

There are two major arguments for regulating the market through the imposition of reserve requirements. One is that the present situation leads to unsafe banking by encouraging institutions to make loans they otherwise would not make. The second is that Euromarket trading fuels the world's inflationary fires by creating money.

The first argument would make sense if reserves were the only tool available to regulators. But as Weatherstone points out: "Several major countries don't even use reserves. Instead they rely on open-